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Supreme Court, U.S.
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No. 94-56

IN THE
SUPREME COURT of the UNITED STATES
OCTOBER TERM, 1994

RICHARD MITCHELL AND LARRY COTTEN,
Petitioners,

v.

STATE FARM FIRE AND CASUALTY COMPANY,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

PETITIONERS' REPLY MEMORANDUM

MILES C. CORTEZ, JR.
Counsel of Record for Petitioners
STEPHEN J. HENSEN
McKENNA & CUNEO
370 - 17th Street
Suite 4800
Denver, CO 80202
(303) 634-4000

Attorneys for Petitioners

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STATEMENT OF THE CASE

Respondent's statement of the case ignores the evidence supporting Petitioners' claim. Accordingly, in keeping with the admonition of Supreme Court Rule 15.1, Petitioners briefly set forth the facts below.

On December 7, 1981, Petitioners Larry Cotten and Richard Mitchell purchased a four-unit condominium complex in Crested Butte, Colorado from the Pokress family. At the time Petitioners purchased the property, it was insured with the Respondent, State Farm Fire and Casualty Company. State Farm consented to an assignment of the policy from the Pokress family to Petitioners.

In May 1982, Mitchell and Cotten obtained a $385,000 line of credit loan from an Arkansas bank, to draw against as needed to pay operating expenses, interest payments and ultimately remodeling expenses on the property. The loan was secured by a deed of trust on the property. As required by the loan documents, State Farm added the bank to the policy as an additional insured and loss payee.

From May 1982 through April 1985, Petitioners drew down against the loan as moneys were needed for the property. Contrary to State Farm's insinuation of improper use of loan proceeds, there was never a dispute between the bank and Petitioners regarding the expenditure of the funds.

Despite State Farm's efforts to imply that Petitioners were responsible for overinsuring the property, the evidence showed that State Farm knowingly overinsured the property for amounts it would never pay. Whenever the loan balance exceeded the insurance coverage, the bank obligated Petitioners to obtain additional insurance coverage to protect the bank's security interest in the property. On each such occasion, Mitchell and Cotten called the State Farm agent, John O'Shea, and explained that they needed to increase the

insurance coverage on the property because the balance on the loan had increased and they needed to ensure that their lenders were fully protected. Each time Petitioners made such a request, State Farm increased the insurance coverage without disclosing that it would pay only replacement cost, not the increased face amount of the policy, in the event of a total loss. State Farm also never disclosed that it had obtained an appraisal placing the replacement cost for the property at only $158,723. Instead, State Farm continued to increase the insurance and collect the ever-increasing premiums. By May 1985, State Farm had increased the insurance on the property to $450,000, almost three times the replacement cost determined by Mr. O'Shea.

On May 26, 1985, the property was totally destroyed by an arson fire. Despite State Farm's continued efforts to imply that Mitchell and Cotten were responsible for the fire, no evidence was adduced that Mitchell or Cotten had anything to do with the fire and State Farm has admitted that it cannot establish that Petitioners committed arson. In fact, State Farm never raised an arson defense.

Petitioners have never disputed that State Farm was entitled to reasonably investigate their claim to determine whether the insured caused the loss. However, State Farm crossed the line of reason and breached its duty of good faith. Shortly after the fire, State Farm began an investigation to establish an arson defense. State Farm hired a lawyer to aid it in "direction toward an investigation leading to possible litigation." State Farm also assigned two adjusters to determine whether Petitioners caused the fire.

One of State Farm's adjusters questioned Petitioners at length and Petitioners fully answered every question. State Farm learned and reconfirmed that Petitioners were in Arkansas, not in Colorado, at the time of the fire. State Farm

concluded that Petitioners were experiencing financial difficulties with respect to the property at the time of the fire, but were otherwise financially solvent.

As the result of its thorough investigation, by September 1985, State Farm knew or should have known that it could not prove the arson defense. Nonetheless, rather than paying the claim, State Farm continued its misdirected efforts to prove that Petitioners caused the fire. State Farm's attorney again interrogated Petitioners for several hours on two separate occasions, and the evidence at trial established that State Farm otherwise engaged in conduct designed to harass and intimidate its insureds. State Farm's attorney finally advised State Farm that the evidence was insufficient to deny Petitioners' claim and recommended that State Farm settle the claim. Despite this advice from its attorney, State Farm still did not pay the claim.

After enduring 14 months of State Farm's unreasonable conduct and refusal to pay benefits, Mitchell and Cotten filed suit on July 10, 1986. On April 30, 1992, nearly six years later, the jury concluded from its review of all the evidence presented that State Farm breached its duty of good faith and fair dealing. The jury found the compensatory damages resulting from the tort to be $256,000. Since the jury also found *beyond a reasonable doubt* that State Farm's tortious conduct was "attended by circumstances of insult or a wanton and reckless disregard of the rights or feelings" of Petitioners, it was permitted to award exemplary damages of $10,000. The jury found in favor of State Farm on Petitioners' claim of breach of contract.

State Farm appealed to the Tenth Circuit Court of Appeals. A panel of the Tenth Circuit vacated the judgment and remanded Petitioners' claim of breach of the duty of good faith and fair dealing to the trial court. The panel

vacated the judgment because it found the jury verdicts inconsistent. Contrary to Respondent's statement of the Tenth Circuit's holding, the court did not find the verdicts inconsistent on the basis that no evidence of $256,000 in damages was introduced. Also contrary to Respondent's representation, the Tenth Circuit never ruled that the verdicts were inconsistent on their face. Rather, the court found the verdicts inconsistent because the jury determined that State Farm did not owe Mitchell and Cotten $450,000 under the contract, but must have measured Petitioners' damages for the breach of duty claim by the difference between $450,000 and the amount State Farm paid to Petitioners' mortgagees.

Mitchell and Cotten submitted a Petition for Rehearing and Suggestion for Rehearing In Banc to the Tenth Circuit. A panel of the Tenth Circuit denied the Petition. Once again, Respondent misstates the Tenth Circuit's holding. Contrary to State Farm's assertions, the court did not find that the jury verdicts were inconsistent because Petitioners did not introduce evidence of $256,000 in damages. Instead, the court determined that the jury was instructed that Petitioners' claim of breach of the duty of good faith and fair dealing was based on unreasonable delay and that delayed payment was not synonymous with overinsurance or misleading conduct.

REASONS FOR GRANTING THE WRIT OF CERTIORARI

A. The Jury Verdicts Can Be Fairly Harmonized Within the Jury's Instructions and the Tenth Circuit's Failure to Reconcile the Verdicts Violates the Seventh Amendment.

In the Opposition to the Petition for Writ of Certiorari, Respondent contends that the jury instructions precluded the

jury from considering the overinsurance aspect of the case in finding that State Farm breached its duty of good faith and fair dealing. Respondent repeats the precise error of the Tenth Circuit by construing the instructions as narrowly as possible in its "search for one possible view of the case that will make the jury's findings inconsistent." *Atlantic & Gulf Stevedores, Inc. v. Ellerman Lines, Ltd.*, 369 U.S. 355, 364 (1962). That analysis is directly contrary to the duty of an appellate court under the Seventh Amendment "to attempt to harmonize [the jury's] answers, if it is possible under a fair reading of them." *Gallick v. Baltimore & Ohio Railroad Co.*, 372 U.S. 108, 119 (1963).

Respondent claims (and the Tenth Circuit ruled) that the jury verdict in this case cannot be reconciled because the jury could not have found both that there was no breach of contract and that there was a tortious breach of duty resulting in compensatory damages of $256,000. However, the verdicts can be fairly harmonized and should have been harmonized by the Tenth Circuit. Under Colorado law, the tort claim of breach of an insurer's duty of good faith and fair dealing is separate and distinct from a claim of breach of contract. *Travelers Ins. Co. v. Savio*, 706 P.2d 1258, 1271-74 (Colo. 1985) (en banc); *Farmers Group, Inc. v. Trimble*, 691 P.2d 1138, 1140-42 (Colo. 1984). The insurer's tort liability does not depend upon its liability under the insurance contract. *Flickinger v. Ninth Dist. Prod. Credit Ass'n*, 824 P.2d 19, 24 (Colo. App. 1991), *cert. denied* (Colo., Jan. 27, 1992). Thus, an insurer can act tortiously and breach its duty of good faith and fair dealing, even if the insurer has not breached the contractual provisions of an insurance policy.

The jury so found here. Respondent acknowledges that the issue of overinsurance was submitted to the jury. (Opp. Br. at 8.) The jury heard evidence that Mitchell and Cotten

contacted State Farm's agent, Mr. O'Shea, and informed him that they needed additional insurance to cover their liability to the bank. (Pet. App. I at 2i-3i.) Mr. O'Shea repeatedly sold them that additional coverage, eventually increasing policy limits to $450,000, despite his undisclosed possession of an appraisal placing the replacement value of the property at only $158,723. (Pet. App. I at 4i-6i.) State Farm presented no evidence that Mr. O'Shea ever informed Petitioners that in the event of a total loss State Farm would only pay replacement value. (Pet. App. I at 13i-14i.) Had he done so, Petitioners would have had the opportunity to look elsewhere for additional insurance to cover the amount of their liability to the bank. Petitioners' counsel pointed out in closing argument that State Farm was aware of the overinsurance problem within three months after the fire, but nonetheless refused to pay the promised coverage. (Pet. App. I at 11i.)

The jury instructions, when considered in light of the evidence submitted to the jury, encompassed the overinsurance aspect of State Farm's tortious conduct. The instruction on the claim of breach of the duty of good faith and fair dealing contained as an element that the insurer "acted unreasonably in delaying payment on plaintiffs' claim without a legitimate basis for said delay." (Pet. App. J at 3j.) Petitioners had made a claim for $450,000, the amount of coverage that Mr. O'Shea had led them to believe they had. The jury must have found that, in light of State Farm's knowledge of the overinsurance problem, it had no legitimate basis for delaying payment of Petitioners' claim for the coverage as represented.

The jury must have found further that the measure of the damage caused to Petitioners by State Farm's wrongful conduct was the difference between the promised amount of coverage (which, as of May 1985, would have covered

petitioners' bank debt) and the amount that State Farm had paid to Petitioners' mortgagees. It is obvious from questions asked during jury deliberations that the Petitioners' obligation to the bank was significant to the jury. (Reply App. A.) It is not inconsistent for the jury to find that the policy language limited State Farm's contractual liability to replacement value, but that State Farm acted tortiously by (among many other wrongful actions during the claims-handling period) unreasonably delaying payment of the amount of protection that Mr. O'Shea led Petitioners to believe the policy afforded them.

Petitioners were forced to wait over seven years after the fire before finally presenting their case to a jury. The jury listened to the evidence, saw the witnesses, and not only concluded that State Farm breached its duty of good faith and fair dealing, but also found *beyond a reasonable doubt* that such failure was "attended by circumstances of insult or a wanton and reckless disregard of the rights and feelings" of Petitioners, thereby warranting an award of exemplary damages. (Reply App. B; Pet. App. C at 3c.) The jury's conclusions should not be disregarded lightly. The District Court found no irreconcilable inconsistency in the jury's verdicts. The Court should grant certiorari to review whether the Tenth Circuit acted contrary to the Seventh Amendment and denied Petitioners their right to trial by jury in reversing that verdict.

B. Respondent's Attempt to Retry the Overinsurance Issue Is Not Appropriate in the Supreme Court.

Without citing any law whatsoever, Respondent argues that certiorari review is unnecessary in this case because Petitioners' overinsurance theory is without merit as a matter of law. (Opp. Br. at 8.) Contrary to State Farm's

characterization, its argument is not a matter of law at all. Rather, Respondent argues that the theory does not apply to the facts of this case. Essentially, State Farm is asking the Court to retry factual issues already established by the jury verdict. Neither the Supreme Court nor the courts of appeals can redetermine facts found by the jury. *Atlantic & Gulf Stevedores, Inc.*, 369 U.S. at 358-59.

The jury heard all of the evidence and determined that Respondent breached its duty of good faith and fair dealing. Among the testimony presented to the jury on the overinsurance theory was that of Professor Garth Allen. Professor Allen testified that insurance industry practices and procedures require an insurer to advise an insured when the insurer knows it will pay substantially less than policy limits in the event of a total loss. Professor Allen did not testify that overvaluation alone constituted unreasonable conduct. Instead, he explained that overvaluation, coupled with the other evidence he reviewed, led him to conclude that State Farm's conduct was unreasonable. State Farm's own expert, J. Kent Miller, acknowledged that an insurance company has a duty to advise an insured that it is overinsuring its property. State Farm did not discharge that duty to Petitioners here.

Based on the testimony, the jury concluded that Respondent breached its duty to Petitioners. The Supreme Court should not now redetermine the facts to conclude that the overinsurance theory was not applicable to this situation.

C. The Respondent's Failure to Raise the Alleged Inconsistency in the Verdicts While the Jury was Empaneled Cannot Be Cured By Claiming Waiver.

As Respondent acknowledges, "a party's failure to object to a verdict on the ground of inconsistency prior to the jury's

discharge waives his right to raise the issue in a post-trial motion or on appeal, unless the verdict is inconsistent on its face so that entry of judgment on the verdict is plain error." (Opp. Br. at 12.) Contrary to Respondent's representation to the Court, the Tenth Circuit never found the verdicts in this case to be "inconsistent on their face." *Id.* Instead, it was only by analyzing evidence of damages and the means whereby the jury derived the figure of $256,000 that the Tenth Circuit determined (erroneously) that the verdicts were inconsistent. Without that analysis of the underlying evidence, there is not even a potential inconsistency in the verdicts. A verdict finding against a plaintiff on a breach of contract claim but for the same plaintiff on a tort claim is not facially inconsistent, where, as here, the claims are submitted to the jury for separate, distinct consideration. *Diamond Shamrock Corp. v. Zinke & Trumbo, Ltd.*, 791 F.2d 1416, 1425 (10th Cir.), *cert. denied*, 479 U.S. 1007 (1986); *accord Resolution Trust Corp. v. Stone*, 998 F.2d 1534, 1547 (10th Cir. 1993).

Respondent seeks to overcome its failure to timely raise the purported inconsistency in the verdicts by pointing to the fact that Petitioners did not raise their waiver argument until the petition for rehearing on appeal was filed. That claim cannot survive either logical or practical scrutiny. Once Respondent allowed the jury to be discharged without objecting to the verdicts on the basis of inconsistency, its right to assert that argument in the future expired. As a matter of logic, Petitioners' failure to call the courts' attention to the waiver cannot revive Respondents extinguished argument.

Furthermore, the reason for the rule requiring that objections on the basis of inconsistency in verdicts be raised while a jury is empaneled is to give the trial court the opportunity to determine the best means of correcting the

inconsistency, including ordering the jury to deliberate further. *Diamond Shamrock Corp.*, 791 F.2d at 1422-23. Unless there is a facial inconsistency in the verdicts, the trial court cannot be expected to notice, in the absence of an objection, that there is a potential inconsistency in the verdicts. *Resolution Trust Corp.*, 998 F.2d at 1574. There is no similar consideration of trial efficiency that would be served by a ruling that Petitioners' failure to immediately raise the waiver argument revived the Respondent's inconsistency claim. Even if Petitioners had raised the waiver issue in response to Respondent's post-trial motion, Respondent could not have cured its failure to raise the alleged inconsistency while the jury was empaneled.

CONCLUSION

For the reasons stated herein, and as set forth in the Petition for a Writ of Certiorari, Petitioners respectfully request that this Court issue a Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit.

Respectfully submitted,

MILES C. CORTEZ, JR.
Counsel of Record for Petitioners
STEPHEN J. HENSEN
MCKENNA & CUNEO
370 - 17th Street
Suite 4800
Denver, CO 80202
(303) 634-4000

Attorneys for Petitioners

APPENDIX

APPENDICES

Appendix A:

Portions of Transcript from Trial Proceedings..... 1a

Appendix B:

Portion of Jury Instructions..... 1b

UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

RICHARD MITCHELL AND LARRY COTTEN,	)	
Plaintiffs-Appellees,	)	No. 92-1208
	)	D.C. No. 86-S-2171
v.	)	
	)	APPELLANT'S APPENDIX
STATE FARM FIRE AND CASUALTY COMPANY,	)	REPORTER'S TRANSCRIPT
Defendant-Appellant.	)	

Appeal from the United States District Court
District of Colorado
The Honorable Daniel B. Sparr

Alan Epstein of HALL & EVANS (William J. Hunsaker of MAKRIS, HUNSAKER, TOWEY & MELONAKIS, P.A., with him on the brief), Denver, Colorado, for Defendant-Appellant.

(The jury left the courtroom at 2:34 p.m.)

[BY THE COURT] All right, Counsel. Remain available. We'll be in recess in this matter.

(Recess at 2:35 until 3:45 p.m. The following proceedings were held in chambers out of the presence of the jury. Mr. Cortez and Mr. Hunsaker were not present.)

[THE COURT] The question is, Is the bank owed any moneys on the loan by Cotten and Mitchell at this time? And if so, what is the dollar amount?

I don't have any intention of answering the question.

[MR. KEILLY] I would agree with that, Your Honor.

[MR. HENSEN] It's reflected on one of the exhibits if they had any questions about it. They can find it for themselves.

[THE COURT] The answer to the question would be that you are to determine the issues of the case based on the evidence. Is that agreeable with everybody?

[MR. HENSEN] That's fine.

[THE COURT] Here it is as it will be returned to the jury. Any other suggestions or objections to the answer?

[MR. HENSEN] None, Your Honor.

[MR. KEILLY] No.

[THE COURT] Very well.

(Recess at 3:47 until 4:45 p.m. The following proceedings were held in chambers out of the presence of the jury. Mr. Cortez and Mr. Hunsaker were not present.)

[THE COURT] All he did was write on the bottom of the old question, Where is the answer?

[MR. HENSEN] Do we just tell them the answer is in the evidence and it's for you to determine that?

[THE COURT] We'll see. Is the bank owed any moneys on the loan by Cotten and Mitchell at this time? And if so, what is the dollar amount? The answer was, You are to determine the issues in the case based on the evidence. And the question came back again, Where is the answer?

* * *

[THE COURT] That's fine. The answer to your question, if any, must be determined by your consideration of the evidence presented by testimony and exhibits -- by testimony, exhibits --

[MR. HENSEN] Or otherwise?

[THE COURT] -- stipulations, or other evidence as defined in the instructions. I cannot comment upon the evidence or find facts as that is the jury's exclusive province. You must rely upon your best recollection of the evidence to answer this inquiry. Is that all right?

[MR. HENSEN] That's acceptable on behalf of the plaintiffs, Your Honor.

[MR. KEILLY] I believe that's acceptable, Your Honor.

[THE COURT] Now, I will cross this out on the previous question and indicate that this is not -- was not presented to the jury. I will not give this question back to them.

[MR. KEILLY] That's fine, Your Honor.

[THE COURT] All right. Take it back.

(Appellant's Appendix Reporter's Tr., Vol. VIII, p. 1094, l. 12-p. 1095, l. 21; p. 1099, ll. 1-18, Trial Proceedings, April 29, 1992.)

INSTRUCTION NO. 31

If you find in favor of the Plaintiffs, and award them actual damages for their claim of Breach of Duty of Good Faith and Fair Dealing, then you shall consider whether exemplary damages should be assessed against the Defendant. If you find beyond a reasonable doubt that the injury complained of was attended by circumstances of insult or a wanton and reckless disregard of the rights and feelings of the Plaintiffs, then in addition to actual damages, you may also assess a reasonable sum as exemplary damages.

Exemplary damages, if assessed, are to be assessed as punishment of the Defendant, and as an example to others.